

STATE OF MONTANA
2005 INVESTMENT POLICY STATEMENT
457 Plan (Deferred Compensation)

INTRODUCTION

The plan was formally adopted by the 1973 legislature and began operation in 1976. The plan is for the exclusive benefit of participants and their beneficiaries. The Montana Public Employees' Retirement Board (MPERB), the plan sponsor, is fiduciary of the plan. Participants make individual investment decisions, subject to the investments offered under the plan and, ultimately, bear the risks and rewards of investment returns.

The purposes of this Investment Policy Statement are to (1) provide investment guidelines for a supplemental retirement-savings vehicle which permits participants to invest on a tax-deferred basis; and (2) allow the plan sponsor, MPERB to meet its fiduciary responsibilities, evaluate the progress of the plan and positively influence its direction.

MPERB will review this Investment Policy Statement annually.

OBJECTIVES

The plan's investment policy is to make available a broad range of diversified investment options that have varying degrees of risk and return. The selection is intended to make it possible for the individual participant to achieve a balanced portfolio consistent with modern portfolio theory.

Return Requirement: The plan will offer a wide spectrum of investment alternatives to maximize the total rate of return to individual participants. Participants may design an investment plan from those alternatives that best meets their individual needs.

Risk Tolerance: Individual participants vary in their level of risk tolerance. Because participants direct their own investments, the plan will offer a wide spectrum of investment alternatives with varying levels of risk and return. MPERB will provide participant education to inform participants of investment alternatives.

INVESTMENT ALTERNATIVES

The plan will maintain at least eight wide-ranging investment alternatives to ensure sufficient choices are available to best meet each participant's personal needs. The investment alternatives must include a fixed income alternative, and may include risk profile/asset allocation funds, publicly traded mutual funds (both retail and institutional), separate account funds, and commingled fund alternatives. Investment guidelines for the fixed income investment alternative are attached as Exhibit 1, State of Montana 457(b) Plan Full Discretion Guidelines. The remainder of this Investment Policy Statement does not apply to fixed income investments.

1. Investment Spectrum Guidelines

The mutual fund, separate account, and commingled fund alternatives come from the following categories:

1. Bond - government or corporate bond fund, active or passive management.
2. Large-cap equity - active or passive management
3. Mid-cap equity - active or passive management
4. Small-cap equity - active or passive management
5. International equity
6. Balanced - combined equity and bond investments in one option
7. Socially responsible fund

The plan may provide additional investment alternatives. The plan may also change the categories of investment alternatives to meet participants' changing needs or changes in the investment industry.

B. Investment Selection Guidelines

The minimum criteria for selecting and evaluating the investment alternatives are:

1. A fund must have a minimum of 3 years* of measurable operating history. A fund that has not been operating for at least 3 years may be measured by its investment manager's history of at least 3 years operating funds that have the same management and investment objectives as the fund being measured. The investment manager's relevant operating history may consist of the management of commingled funds, mutual funds, or a composite of funds. A composite is a group of "separate account" funds managed under the performing standards of the Association for Investment Management and Research (AIMR).
2. Funds that require participants to pay either front or back end load fees will not be considered.
3. A fund must have an expense ratio (internal expense charge plus any 12(b)-1 fee) no greater than the mean for the fund's peer group.
4. The Sharpe Ratio Test for the most current 3-year period* must meet or exceed the 50th percentile Sharpe Measure of an appropriate industry accepted database, approved by the MPERB, containing a sufficient number of funds in the same asset class and investment category.
5. Fund rate of return for the most current 3-year period* must meet or exceed the 50th percentile return of an appropriate industry accepted database, approved by the MPERB, containing a sufficient number of funds in the same asset class and investment category.
6. A fund must receive a Morningstar Category Rating of 3 stars (neutral) or higher for the most current 3-year period*.

*Note: The most current 5-year period will also be used and equally weighted when available.

C. Evaluation of Investment Alternatives

The performance of all plan investment alternatives will be evaluated on at least an annual basis. The evaluation must be conducted by an appropriate third party provider, by the Employee Investment Advisory Council (EIAC), or by the Montana Board of Investments. Each investment alternative will be compared to its peers and the appropriate benchmark. In addition, each investment alternative will be reviewed for other indicators including, but not limited to, style drift, duplication, fund manager or other organizational changes. Investment alternatives that are determined to have a sub-standard performance rating or other negative indicators may be recommended for probation or termination by EIAC. The EIAC will report the evaluation results and EIAC's recommendations to the MPERB, which will make the final determination whether to continue a fund, place a fund on probation, or terminate participation in a fund.

Plan investment alternatives which have been placed on probation by MPERB will be evaluated on a quarterly basis.

D. Closure of an Investment Alternative

The MPERB will notify participants in a terminated investment alternative to transfer their fund balance to another investment alternative within a reasonable period time (usually 3 months). If a participant fails to transfer a fund balance in the time provided, MPERB will transfer the fund balance from the terminated investment alternative to an investment alternative similar in investment category and style selected by MPERB to replace the terminated investment alternative. If a terminated investment alternative is not replaced, MPERB will transfer the fund balance from the terminated investment alternative to the stable value fund.

CONSTRAINTS

Liquidity Needs: Participation in the plan is optional. Participants may withdraw or transfer their funds from the plan under certain circumstances, subject to possible adverse tax consequences. Participants may, on a daily basis, move their assets from one investment alternative to another. Therefore, the plan's liquidity needs are high. MPERB must ensure that sufficient liquid assets are available to meet the plan's liquidity needs while also ensuring daily investment earnings on those assets.

Time Horizon: Time horizons vary for individual participants. Because participants direct their own investments, there is no time horizon expressed for the total fund. Investment choices will be offered that provide participants with a wide variety of time horizons, depending on a participant's unique needs. However, because retirement funding is the most important goal, the plan will offer quality investment alternatives that provide participants with favorable long-term returns.

Tax Considerations: The plan is exempt from federal and state income taxes. Participants' contributions to the plan are not taxed. The appreciation of participants' assets in the plan is not taxed. Therefore, tax-advantaged investments are not offered by the plan.

Legal Considerations: The plan is governed by applicable federal and state statutes and regulations, including Section 457 of the Internal Revenue Code of 1986, as amended, and Title 19, chapter 50 of the Montana Codes Annotated. MPERB's Deferred Compensation Plan Document provides additional legal information.